



## REEP: Research Unit on the Economics of Excisable Products

with the

### WHO FCTC Knowledge Hub on Tobacco Taxation

Newsletter #21, September 2022

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## Director's Message

Dear Friends

As the year enters its last quarter, we want to share some of REEP's activities from the past two months with you. We report on a number of trips abroad, a two-week long Knowledge Hub workshop, some publications and some presentations.

You will notice that a substantial number of the contributions in this month's newsletter refer to illicit trade in South Africa. See the articles on presentations made by REEP staff to [tobacco control stakeholders](#), [National Treasury](#), the [PHASA conference](#), and [Mensa](#), and papers published in the [Econ3x3 series](#) and [Tobacco Control](#). The illicit trade situation in South Africa is a cause for much concern. Recent estimates by Nicole Vellios of REEP indicate that the illicit market share breached 50% in 2020 and stayed above 50% in 2021.



We were heartened by the recent reports (see [here](#) and [here](#)) that SARS has placed Gold Leaf Tobacco Corporation (GLTC) under curatorship because of their illicit trade and money laundering activities. Our research indicates that, even before the 2020 sales ban, many tobacco companies were selling cigarettes at prices that were so low that it is impossible that the tax was paid. During the sales ban, even though the sale of cigarettes was banned, cigarettes from all cigarette companies were being sold. GLTC was the dominant company during the sales ban.

We hope that SARS's action against GLTC is the first of many. From my reading of the news reports, the action against GLTC was not based on their activities during the sales ban, but on what had happened in the years prior to the ban. It only got worse after 2018. If SARS were to home in on GLTC's activities during the sales ban, it would find even more incriminating evidence. We also hope that SARS will expand their investigations to other tobacco companies. We congratulate SARS and wish them well in their investigations.

I hope that you enjoy this newsletter.

Kind regards

**Corné van Walbeek**

Director: Research Unit on the Economics of Excisable Products



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## Knowledge Hub hosts 8th workshop on Tobacco Taxation

The [WHO FCTC Knowledge Hub on Tobacco Taxation](#) recently hosted its eighth workshop on tobacco taxation. The online workshop took place over two weeks.



The first track, which covered all the important issues in the economics of tobacco taxation (such as the law of demand, elasticity of demand, tax structures, affordability, tax modelling and illicit trade), ran from 5 to 9 September 2022 and was open to the public. Guest presenters included Catherine Egbe from the South Africa Medical Research Council, Evan Blecher from the World Bank, Martin Grande from the WHO FCTC Secretariat, Estelle Dauchy from the Campaign for Tobacco Free Kids, and Jeff Drope from the Tobacconomics team at the University of Illinois in Chicago. More than 80 participants from 22 countries joined the sessions daily.

The second week (12-16 September 2022) was a closed session for participants from selected countries, focusing on tobacco tax simulation modelling. Five countries (Botswana, Colombia, Maldives, the Philippines and Zambia) participated in these sessions. Modelers from the REEP team designed country-specific models for each country and provided recommendations for tax reforms for the countries to consider. The Knowledge Hub will be engaging with these countries in the next phase to provide technical assistance depending on the context and needs of each country.

## The Knowledge Hub supports officials in Suriname on tobacco taxation

In August 2022, Corné made a [presentation](#) to the National Assembly of Suriname on tobacco taxation. He provided an overview of tobacco control policy, the role of tobacco taxation, and the issue of illicit trade. The presentation to the National Assembly was preceded by a technical discussion about tobacco taxation and illicit trade with officials from key government departments, including Health, Finance, Customs, the Economic Control Unit, and the revenue authority. Zunda, Senzo and Hana attended the technical meeting online.



Suriname has a uniform specific tax system. The excise tax on tobacco products in Suriname is set in US dollars, rather than in the local currency. Since 2011 the level of the excise tax has remained unchanged. In recent years the illicit trade in cigarettes in Suriname has become a significant problem. To address the illicit trade, the tobacco industry recommended that the government should introduce a tiered tax system, where the to-be-introduced lower tax tier would somehow bring the illicit cigarettes into the tax system. Earlier in 2022, officials from the Health Ministry asked the Knowledge Hub to comment on this proposal. We argued that this proposal was self-serving for the industry, would not solve the illicit trade problem, and would probably reduce government revenue. Illicit trade is primarily a criminal issue, not a tax issue. As a result of this intervention, the suggestion of a tiered tax system was shelved.

The fact of the matter remains that Suriname has an illicit trade problem. The industry estimates that it is as high as 80%. This is an exaggeration. Rough estimates by REEP suggest that it can be as high as 50%. In his [presentation to the National Assembly](#), Corné indicated that the solution to the illicit trade problem lies in securing the supply chain, through the various mechanisms outlined in the [Protocol to Eliminate Illicit Trade in Tobacco Products](#). These include a track and trace system, licencing protocols, and international cooperation. Based on the results of the Tobacco Excise Tax Simulation Model (TETSIM) using Suriname's data, Corné showed that even in the presence of illicit trade, an increase in the excise tax would have positive fiscal and health consequences, although the illicit market does dampen the impact of a tax increase.



## REEP strengthens its relationship with Tax Justice Network Africa

Between 29 and 31 August 2022, Corné attended a meeting of **Tax Justice Network Africa** (TJNA) in Abuja, Nigeria, with the aim of strengthening the relationships between REEP and TJNA. TJNA supports advocacy groups in five African countries (**ILDI** and **Cenco** in DRC, **VALD** in Ghana, **NTA** in Kenya, **CISLAC** in Nigeria and **CPTD** in Zambia) to argue for better tobacco-tax structures and higher tobacco taxes in their respective countries. Most of these tax advocacy groups did not have previous experience in tobacco taxation. Over the past 18 months, REEP has supported them by providing detailed comments on their tobacco-related research.



The meeting was an opportunity for these groups to report on their activities of the past 18 months. It was clear that a lot of learning has taken place. Corné emphasised that academic research and advocacy efforts depend on each other. Academic research by itself is sterile. Advocacy efforts without strong empirical backing are dangerous. The two need each other.

A very useful tool for the tax advocacy groups is the Tobacco Excise Tax Simulation Model (TETSIM). This model has been developed over many years and allows the user to estimate the likely public health and fiscal outcomes of a tobacco tax change (in terms of the structure of the tax system, or the level of the tax). REEP has agreed to build and calibrate TETSIM models for each of the five countries, in partnership with the various tax justice groups. Rather than simply appealing to the public health rationale for an increase in the excise tax ("smoking kills; increase the excise tax"), these models will allow these groups to explain the economic rationale for an increase in the excise tax, and thus to be more effective. Furthermore, in the next 12 months REEP will develop a curriculum in tobacco taxation, similar to the curriculum that is currently used for the Knowledge Hub workshops, as a training tool for staff.

## REEP presents at conference of the Public Health Association of South Africa



Corné van Walbeek recently presented REEP's research vision for the foreseeable future at the Public Health Association of South Africa (PHASA) conference held in Durban. The presentation was part of a

symposium, organised by the Tobacco, Alcohol and Other Drugs Research Unit (ATODRU) at the SA Medical Research Council. In his [presentation](#), Corné highlighted the fact that illicit trade comprised more than 50% of the tobacco market in South Africa in 2020 and 2021. If the illicit market is not brought under control, all other tobacco control interventions are likely to be less effective or even completely ineffective. Corné mentioned that SARS's prosecution of the Gold Leaf Tobacco Corporation marks a potential turning point in the fight against illicit cigarettes. Future research areas for REEP were discussed among colleagues in previous months and were presented at the conference. The following are the research priorities:

- **Political economy aspects of tobacco control in South Africa:** What are the barriers to implementing the current legislation? Why has a track and trace system not been implemented yet? What are the changing power dynamics in the tobacco control landscape?
- **Illicit trade:** There is a continuous demand for current estimates of the size of the illicit market and how the illicit market is evolving. Although REEP has done a lot of work on the characteristics of purchasers of illicit cigarettes, a deeper understanding is required, e.g. do buyers know that they are buying *illicit* cigarettes, not just *cheap* cigarettes? Do they care? Is brand loyalty changing? Do smokers switch from licit to illicit cigarettes as a spending strategy, depending on how much money is left at the end of the month?
- **Electronic nicotine and non-nicotine delivery systems (ENDS/ENNDS):** As economists, we are not qualified to comment about relative risks of these products. However, we should analyse the economic aspects of these products, including the following: prevalence of use (including dual use with cigarettes) by demographic and socio-economic group, gateway effects, and the sensitivity of the demand for ENDS/ENNDS to changes in the own price and the price of traditional tobacco products.
- **Smoking and youth:** The Global Youth Tobacco Survey (GYTS) focuses on children aged 13 to 15. Smoking patterns among older youth are not covered well in existing surveys. We hope in the future to be able to conduct a comprehensive survey of tobacco, e-cigarette and alcohol use among adolescents and young adults.
- **Industry response:** The past decade has seen a major change in the tobacco industry's structure, in which the power of the multinationals has been greatly undermined by low-price local manufacturers. Cigarette prices have diverged over time, and currently are between as low as R10-R20 for a pack of illicit cigarettes and as high as R50-R60 for a pack of premium cigarettes. This has implications for tobacco control policy.
- **Trade agreements and their impact on taxation policy in South Africa:** Currently Botswana and Eswatini impose a levy in excess of the excise tax (of R19.82 per pack) that is imposed in all five member countries of the Southern African Customs Union (SACU). The aim of these additional levies is to reduce tobacco use in these countries and to generate extra revenue. It also results in differences in the retail price of cigarettes in the SACU member states. To what extent can these additional taxes/levies in the neighbouring countries put pressure on the SA Treasury to increase the excise tax for the whole SACU region?

The presentation is available [here](#).

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## REEP presents at National Treasury public hearing

Recently the [National Treasury asked for public comments on tobacco taxation](#) and the structure and level of the new excise tax on e-cigarettes. REEP made [written submissions](#) and an [oral submission](#) at the online public meeting held on 8 September 2022.

In the [submission](#) on tobacco excise taxes, we pointed out that the National Treasury had increased the excise tax by an average of 2 percentage points above the inflation rate in the past ten years. This is substantially less than the excise tax increases of the previous two decades.

Since 2009, the illicit trade in tobacco products has grown from insignificant levels to highly problematic levels. It seems that National Treasury is of the opinion that the illicit trade in tobacco products is not primarily a tax problem, but rather a crime and enforcement issue. We indicated our delight with the actions taken by SARS against Gold Leaf Tobacco Corporation, who had been involved in the illicit tobacco business for years.

Regarding the taxation of e-cigarettes, the National Treasury published a very well-argued [discussion document](#) in December 2021, to which REEP [responded in January 2022](#). The e-cigarette market is growing, and e-cigarette technology is changing very rapidly. The excise tax on e-cigarettes should handle such changes. Specifically, we highlighted that the following principles should underlie e-cigarette taxation:

- Simplicity in tax design and tax administration
- Preventing youth uptake of e-cigarettes
- Robustness to technological changes
- Not easily avoidable through loopholes

Of course, some of these principles may counteract others, and they are not absolute. We advised National Treasury to set the excise tax as a specific tax per ml of e-liquid, irrespective of nicotine content, because it would be administratively arduous to test each product for nicotine content. We did not recommend an excise tax on devices, because that would be administratively burdensome and would be subject to evasion tactics by the industry.

We recommended that National Treasury adopt a minimum tax amount (say R50) per container, to discourage youths from buying disposable e-cigarettes that contain a limited volume of e-liquid. For example, many youths are buying AirPops, disposable e-cigarettes that contain 3 ml of nicotine, which



which sell for about R100 a unit. Even if the excise tax is levied at R5.00 per ml (as we suggested), the impact of the tax on the retail price would be limited. If a minimum tax of R50.00 per container is imposed, the effect on the price of products like these would be more substantial.

## Nicole Vellios presents PhD results to tobacco control community and policy makers

On 7 September 2022, Nicole presented results from two of her three PhD chapters (one on plain packaging, and one on illicit trade) at an online seminar attended by about 30 stakeholders. These included people from the South African Revenue Service, the National Department of Health, health advocacy groups, as well as researchers and journalists.



In the plain packaging chapter, Nicole investigated whether the type of cigarette packaging reduces the utility of cigarettes. Preferences were elicited using a discrete choice experiment. In such an experiment, each respondent is shown a series of choice sets. In each choice set the respondent is asked to choose one of three packs that have different characteristics (plain pack versus current pack, different prices, and sticks with warnings versus sticks without warnings).

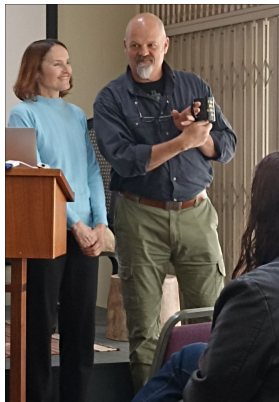
Data were collected in 2021 from UCT students. Both smokers and non-smokers were sampled. Nicole found that plain packaging would be effective in reducing people's utility for cigarettes. Smokers preferred not to buy plain packs and non-smokers preferred not to try plain packs. In terms of health risk, both smokers and non-smokers perceived plain packs to be the most risky.

The results from Nicole's illicit trade chapter were alarming. The chapter considered the illicit market between 2002 and 2017. Between 2002 and 2009 the illicit market accounted for around 5% of the total market. Despite the industry's arguments at the time that illicit cigarettes comprised 20% or more of the market, the illicit market was modest. The illicit cigarette market started increasing sharply after 2009. By 2017, illicit trade accounted for 30%–35% of the total market. Nicole found no evidence that excise tax increases were linked to an increase in illicit trade. When excise taxes were increasing rapidly, illicit trade was stable (2002–2009). On the other hand, when excise tax increases were relatively modest, illicit trade increased rapidly (2009–2017).

Nicole updated the results in August 2022. In 2020 and 2021, illicit trade was estimated to account for 54% of the total market. The results are available [here](#).

A recording of the seminar is available on [request](#).

## REEP researcher presents at Mensa gathering in Cape Town



Mensa is a high IQ society with branches in around 90 countries worldwide. Hana Ross was invited by the Cape Town Mensa chapter to provide an update on the illicit cigarette market in South Africa, on the 3rd September 2022.

In response to the Covid-19 epidemic the South African government banned the sale of tobacco products for 20 weeks in 2020. The stated aim of the ban was to decrease both disease severity among infected smokers and the demands on the health system. Unfortunately, the ban had a [negligible effect on smoking prevalence](#), but greatly increased the market share of untaxed cigarettes, resulted in a massive loss of revenue.

Despite the ban, the sale of cigarettes did not cease. The cigarette market became 100% illegal in one day. Most smokers continued smoking despite the fact that average prices of cigarettes increased by [more than 200%](#) at the peak of the ban.

The sales ban permanently altered the cigarette market. Even after the ban was lifted in August 2020, the market did not return to its pre-ban position. Cigarette prices decreased, relative to the prices charged during the sales ban, but were higher than they were before the ban, without any change in tax. Purchases shifted away from the normally dominant brands of the multinational tobacco companies to local/regional producers,

About 7.9% smokers indicated that they quit during the sales ban period, but about half of them indicated that they started smoking again after the sales ban was lifted.

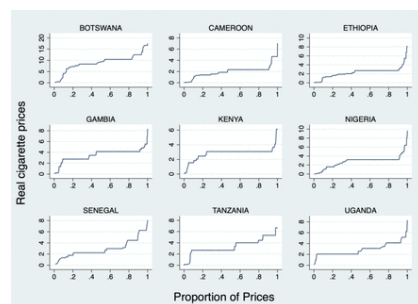
More importantly, the market share of illicit cigarettes grew during and after the sales ban. Whereas the market share of illicit cigarettes was around 30% before the ban, recent REEP estimates indicate that it has increased to more than 50% in 2020 (the year of the ban) and [remained above 50%](#) in 2021, well after the sales ban was lifted.

The South African government's report on the impact of Covid-19 on various spheres of society and the economy was published on 30 June 2022. The report states that "The tobacco sales ban seems to have been counterproductive. It had only a limited impact on the prevalence of smoking, but the already strained fiscus lost about R6 billion in excise revenue during the ban. More significantly, the sales ban entrenched illicit distribution channels".

## REEP colleagues publish article on tobacco excise tax structures in *Tobacco Control*

In August 2022, Samantha Filby, Corné van Walbeek and Liping Pan of the CDC Foundation published a paper in *Tobacco Control* titled "[Cigarette excise tax structure and cigarette prices in nine sub-Saharan African countries: evidence from the Global Adult Tobacco Survey](#)".

Although increasing the excise tax on cigarettes is a key mechanism for reducing cigarette consumption, the impact of a tax increase on consumption can be greatly reduced if it is easy for smokers to switch to cheaper brands when taxes and prices increase. The ability to substitute to cheaper brands can be measured by the distribution of cigarette prices within a country. Specifically, if cigarette price variation is small, smokers are more likely to quit or reduce consumption, instead of switching to a cheaper brand in the event of a tax-led price increase.



Economic theory predicts that the excise tax structure influences the distribution of cigarette prices. The paper provides the first comparison of the distribution of cigarette prices, under different excise tax structures, for nine African countries. The authors find that the smallest price variability exists in countries with a uniform specific tax, or with a mixed system with a minimum specific floor that effectively works like a uniform specific tax. Price variability is greatest in those African countries that have adopted an ad valorem tax structure.

These results align with the international literature that indicates that simple excise tax structures are the most effective at reducing cigarette consumption. The paper thus provides Africa-specific evidence for governments to improve excise tax structures in order to improve public health.

The paper is the second of five papers that have been funded by the Bloomberg Initiative to Reduce Tobacco Use through the CDC Foundation with a grant from Bloomberg Philanthropies. The aim of the funding is to use Global Adult Tobacco Survey and Global Youth Tobacco Survey data to investigate important economic relationships in tobacco control in Africa. When it comes to the economics of tobacco control, Africa is often under-researched. This paper is part of a strategy to address this issue.

To learn more about the Global Youth Tobacco Survey and Global Adult Tobacco Survey data, please visit the CDC Foundation's [GTSS Academy](#).

Read the paper [here](#).

## Recently published paper looks at break-even cost of a Track and Trace system

On 14 September 2022, *Tobacco Control* published a paper titled "[How much to pay for a track and trace system: a simulation model for South Africa](#)". The authors are Kirsten van der Zee, Corné van Walbeek and Hana Ross. The team developed an Excel-based simulation model which determines the break-even track and trace (T&T) cost per pack, should the government decide to implement such a system. At this cost, the government would recover all costs associated with implementing T&T by collecting additional tax revenues. If the actual cost is less than the break-even cost, the project would be economically feasible.

Independent T&T systems are considered one of the most effective measures available to reduce the illicit tobacco trade. The illicit cigarette trade is a particularly big challenge in South Africa, where it is estimated to comprise more than 50% of the total cigarette market. Using scenario analysis, the paper estimates that a T&T marker cost of between R2.68 (US\$0.17) and R5.24 (US\$0.34) per pack would allow the South African government to collect enough additional revenue to recover all costs associated with T&T. Given that existing T&T systems cost significantly less than this range (roughly US\$0.02 per pack), the government would in all likelihood be able to implement T&T at a cost well below the break-even rate, thus generating additional revenue.

Other than raising additional revenue, a T&T system will have positive public health consequences. The model indicates that implementing such a system would reduce cigarette consumption by between 5% and 11.5%.

The break-even simulation model provides a practical tool for the government to plan the implementation of T&T and to set up an evaluation criteria for the T&T tender process. Implementing a T&T system in South Africa would reduce legal and illicit cigarette consumption and generate additional revenue. With some modifications, the model can be applied to other countries as well. The paper is available [here](#).

## Latest illicit trade estimates published in Econ3x3

On 7 September 2022, Nicole published a [report](#) on illicit trade and the industry's estimates of the size of the illicit market in Econ3x3. [Econ3x3](#) is a platform for concise, accessible, policy-relevant, research-based contributions and expert commentaries. The report was written in response to a media statement by British American Tobacco South Africa (BATSA) at the end of August 2022 that illicit cigarettes in the past year comprised 70% of the local market. To test the validity of this claim, Nicole updated her previous [research](#) that provided estimates of illicit trade from 2002–2017.

Using gap analysis, she estimated that between 2002 and 2009 the illicit cigarette market accounted for around 5% of the total market. Since 2010, however, the illicit cigarette market has increased sharply. By 2017, it accounted for 30%–35% of the total market. The tobacco sales ban of 2020 entrenched the illicit market further. Even after the sales ban was lifted in August 2020, the illicit market still flourished. Nicole estimated that illicit trade was 54% in 2020 and 2021. These estimates are lower than BATSA's estimate of 70%, but are still a cause for much concern.

In the Econ3x3 paper, Nicole explains that [BATSA's estimate](#) is wrong for two reasons: (1) the estimate is only for Gauteng (one of the nine provinces in their sample), not South Africa as a whole (their national average is in fact 34%), and (2) its estimate relates to the *proportion of stores* that sold illicit cigarettes, as opposed to the overall proportion of illicit cigarettes consumed. It is quite possible that stores that sell illicit cigarettes also sell legal cigarettes. Even if the 70% figure were true for the country, rather than claiming that 70% of the market is illicit, BATSA should say that that 70% of retail outlets sell illicit cigarettes. BATSA's current depiction is misleading.

Nicole's article is available [here](#).

### Percentage of illicit trade in the total market

Illicit trade was around 54% in 2021



Source: Self-reported consumption data sourced from the All Media and Products Surveys (2002–2015) and the Global Adult Tobacco Survey (2021). Tax-paid sales data sourced from National Treasury and the Department of Trade, Industry and Competition · Created with Datawrapper

### In the news

- Kirsten van der Zee spoke with Stephen Grootes about illicit trade in SA on [SAFM](#) on Tuesday 30 August 2022.
- As profiled above, Nicole Vellios wrote an [op-ed in Econ 3x3](#) on the size of illicit market in South Africa on 7 September 2022. Weighing in on an ongoing debate, she showed how the industry estimates can be quite misleading. This was picked up on the same day by Gill Gifford from Times Live who wrote an article citing Nicole's original article: "[Diseased teeth, 'stick' warnings and taxes deter smokers](#)" (please note that the Times Live article requires subscription), and resulted in her being interviewed on [Radio Islam](#) on 21 September 2022.



Regards,  
The REEP team

If you have any comments or feedback on this e-newsletter, or suggestions for possible story ideas for our next issue, please get in touch with the REEP team, by emailing us at:



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